#36, 4 October 1999

A publication of the International Centre for Policy Studies

ICPS newsletter

New economic legislation: impact on business activity

While Ukraine's economic legislation is intended to provide a framework for business activities, it has lacked an integrated and publicly available analysis of its impacts on the development of a market economy in the country. The last issue of the monthly ICPS Policy Studies journal contains an independent evaluation of changes in the legal framework with regard to their impacts on market reform feasibility in Ukraine, and on the shaping of the investment climate and business environment, provided by experts of ICPS and the analytical-expert group of the Coordination and Analysis Center for Policy Studies

Policy intervention impacts of new economic legislation are evaluated with regard to improvement or deterioration of the investment climate and business environment in Ukraine. Policy is treated as a dynamic, focusing on changes passed since summer 1998 and outlining future developments.

The analysis of new economic legislation involves the following steps:

· defining problems and issues that call for legislative action in shaping the investment climate and business environment in Ukraine;

· selecting legislative documents designed to solve the above-defined problems;

· evaluating the impacts of the laws and decrees and their effectiveness in dealing with business issues;

· outlining prospects for future developments in legislation.

Experts chose the most important laws and presidential decrees passed in the period from April 1998 to September 1999 that had impacts in the areas of:

· regulation of businesses;

· taxation;

· foreign trade;

· foreign direct investment;

· special economic zones;

· contract enforcement;

· privatisation and securities market development;

· regulations in the energy sector, agriculture, and banking.

The changing role of the government during Ukraine's transformation from a centrally planned to a market economy has resulted in a lack of consistency in developing a legal framework for business activities and investments. While the government's objective in a market economy is to provide a competitive environment for economic activities, actual decisions by the Ukrainian government, still burdened with the Soviet legacy, are biased towards tightening control over the economy. Consequently, legislative actions frequently negate each other, creating an uncertain business climate.

Although the Ukrainian Constitution declares the right to free economic activity, government approaches to regulation of businesses hardly adhere to this principle. Various government bodies interfere in the day-to-day activities of businesses, increasing their costs. The response of private businesses is to work in the shadow economy. The only way out is to develop a consistent regulatory framework, entailing greater transparency of regulation and redefining government functions.

Last Week

New project was started.

On September 27 the Canadian Embassy hosted the official opening ceremony for the Economic Forecasting and Modelling in Ukraine project. This project is implemented jointly by the Conference Board of Canada (CBoC), the International Centre for Policy Studies and the Ukrainian government represented by the Ministry of Economy, the Ministry of Finance and the National Bank of Ukraine. The project is funded by the government of Canada through the Canadian International Development Agency and is part of technical assistance program.

The overall objective of this three-year project is to strengthen the institutional capacity of the Ukrainian government in the area of economic policy development. Government officials should obtain skills of usage, design, and modernisation of analytical tools for developing sound advice regarding economic policy implementation.

Officials from the government bodies will participate in the project as trainees. Twice a month officials will attend seminars at ICPS, where they should improve their own understanding of market economy, study problem of data collection and quality, and learn principles of database creation and usage for developing model of Ukrainian economy. CBoC economist will carry out the majority of the training. Trainees will also be involved in the construction of the Ukrainian economy econometric model.

Economists of the ICPS's Quarterly Prediction team will participate in the project both as trainees as well as advisors of government officials.

For further information contact Oksana Remiga, project coordinator, e-mail: ORemiga@icps.kiev.ua

This Week

What exchange rate system is the most suitable for Ukraine? ICPS's macroeconomic seminar, planned on October 5, will be devoted to the subject "Into the year 2000 with a crawling peg system". Participants will discuss the following questions:

1. Which exchange rate system should be implemented? To which nominal anchor, exchange rate or possibly a monetary aggregate should preference be given?

2. How should the transition phase from the present system to a successor regime be implemented?

Presentation will be made by Mr. Gerhard Krause, expert at the German Advisory Group on Economic Reform to the Ukrainian Government.

Next Week

2000 budget impact on economic development. ICPS's macroeconomic seminar, devoted to the subject "Evaluation of the Budget 2000 and its Macroeconomic Consequences in 2000-2001", will be held on October 12. Presentations will be given by Mr. Marek Dabrowski, senior CASE advisor, Ms. Malgorzata Markiewicz and Ms. Katarzyna Pietka, CASE consultants.

Concerning invitations for ICPS's seminars, please contact Larysa Romanenko. E-mail: LRomanenko@icps.kiev.ua tel.(380-44) 463-5967

ICPS Newsletter is a weekly publication of the International Centre for Policy Studies delivered by electronic mail.
To be included in the distribution list mail to: marketing@icps.kiev.ua.
ICPS Newsletter is published by the ICPS Publications Group.
ICPS Publications director Hlib Vyshlinsky (hlib@icps.kiev.ua)
ICPS Newsletter editor Yevhenia Yehorova (ee@icps.kiev.ua)
Phone (380-44) 463-6337
Fax (380-44) 463-5970
English text editor D. (Ksenia) Ovcharenko.
Articles may be reprinted with ICPS consent.
Address: 8/5 Voloska Street,
Kyiv 04070, Ukraine
Web-site: http://www.icps.kiev.ua

A new approach to regulation is being implemented by ensuring compatibility of various government decisions with the goal of promoting competition. Consistency of the regulatory framework is achieved by the government doing cost-benefit analyses of interventions and evaluating their impact on incentives for businesses, as suggested by the draft Conception of the State Regulatory Policy. Providing a competitive environment includes improving entry and exit regulations, simplifying registration and licensing procedures, and enforcing safety regulations. In addition, implementation of international accounting standards will facilitate entry of foreign businesses into Ukrainian markets.

Evolution towards better a taxation system in Ukraine primarily requires reduction of compliance costs and equalising the tax burden across different businesses. Experts consider that an important step forward in improving Ukraine's taxation was the passing of the presidential decree on a single tax for small and medium enterprises that significantly decreased compliance costs for businesses. Meanwhile, the tax policy aimed at providing incentives for businesses and investors is under risk, due to the lack of a balanced fiscal strategy. "Fire-fighting" measures to increase government revenues, including imposing additional taxes and levies, worsens the business environment by increasing the cost of doing business in Ukraine.

Foreign trade regulations are contradictory, consisting of declarations for trade liberalisation, on the one hand, and legislative decisions on augmenting protectionism, on the other. Ukraine's goal to join the World Trade Organisation requires liberalisation of foreign trade and abolishing export and import restrictions. Meanwhile, a series of protectionist legislative acts has been passed, including imposing export duties on scrap metals and sunflower seeds. Frequent and contradictory changes in foreign trade regulations contribute to uncertainty when making business decisions in Ukraine.

Lack of a balanced strategy aimed at improving the investment climate in Ukraine also impedes the development of a legal framework to encourage foreign investments. Foreign investors are given tenuous privileges in certain sectors instead of implementing an integrated policy to stimulate foreign investment. In particular, a series of documents has recently been passed on establishing special economic zones. Whereas the special economic zones are expected to attract foreign investments, there is a risk of growing government interference in business activities within these zones.

Long-awaited developments in contract enforcement include new bankruptcy procedures passed by amendments to the Law on Bankruptcy. The law stipulates a priority for claims on contracts with pledges. This procedure is expected to stimulate promotion of pledges as a mechanism for enforcing contracts. Enhancing contract enforcement mechanisms reduces the risks of business activities and promotes efficient resource allocation. Another improvement in contract enforcement is asset liability for tax debts, which replaces the kartoteka debt requisitioning system.

Institutional reinforcement of private ownership rights requires effective privatisation procedures. On the one hand, there is sufficient awareness of the necessity of cash privatisation that ensures selection of the most effective owners. On the other hand, political instability and vested interests impede successful implementation of cash privatisation. The delay in cash privatisation is hindering the development of a securities market, although much endeavour has gone into establishing the institution of a National Depository.

Finally, researchers picked up three specific sectors – agriculture, banking, and energy – that have endured most frequent government interference. Inconsistent government regulations increase the risks and costs of doing business in these sectors. Land reform is expected to reduce government interference in agriculture. Similarly, the National Bank's reliance on rules instead of discretion in banking regulation would increase the business attractiveness of this sector. Lastly, enhancing contract enforcement mechanisms in the energy sector is expected to improve payment compliance for energy supplies and to awaken market forces in this sector.

If you wish to receive the complete version of the New Economic Legislation, 1998-1999 analysis, please send your information to the e-mail address: marketing@icps.kiev.ua or contact Oleksii Blinov, ICPS marketing office, tel. (380-44) 463-6337